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SMALL BUSINESS LENDING REAUTHORIZATION AND IMPROVEMENTS ACT OF 2007

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Mr. KERRY, from the Committee on Small Business and Entrepreneurship, submitted the following

R E P O R T

[To accompany S. 1256]

The Committee on Small Business and Entrepreneurship, to which was referred the bill (S. 1256) to amend the Small Business Act to reauthorize loan programs under that Act, and for other purposes having considered the same, reports favorably thereon with an amendment in the nature of a substitute and recommends that the bill (as amended) do pass.

I. INTRODUCTION

The Small Business Lending Reauthorization and Improvements Act of 2007 (S. 1256) was introduced by Senator John F. Kerry, for himself and Senators Snowe and Levin, on May 1, 2007. The bill reauthorizes the SBA's microloan programs, the 7(a) Loan Guaranty program, and the 504 Loan Guaranty program for Fiscal Years 2007, 2008, 2009, and 2010. In addition to making significant improvements to the SBA's lending programs, the bill also authorizes two new pilot program initiatives.

During markup of the bill, the Committee unanimously adopted by voice vote, a bipartisan managers' substitute amendment, offered by Chairman Kerry for himself and Ranking Member Snowe, which incorporated modified versions of amendments filed by Senators Isakson, Bond, and Enzi regarding the reduction of 7(a) loan fees, the Child Care Lending Pilot Act, and the Microloan program. The bill was subsequently adopted as amended by a roll call vote of 19–0.

The Small Business Lending Reauthorization and Improvements Act of 2007, S. 1256, is the product of a series of hearings, meet-

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ings and roundtables held in 2006 and 2007 that examined the capital needs of small businesses and sought to determine whether the SBA's loan programs were serving their purpose and whether legislative changes were needed. The bill incorporates virtually all of the lending provisions that were unanimously adopted by the Committee in the 109th Congress as part of the "Small Business Reauthorization and Improvements Act of 2006," S. 3778, a comprehensive reauthorization bill developed under Senator Snowe, then the chair of the Committee. S. 1256 builds on the Committee's work of the 109th Congress, making significant changes to the SBA's 7(a) Loan Guaranty program, the Agency's largest small-business loan program. The bill also institutes a rural outreach lending program designed to increase lending in rural areas, modifies the 504 Loan Guaranty program to provide incentives to increase business development in low-income communities, adopts versions of proposals by the Administration to make uniform the real estate appraisal requirements for 7(a) and 504 loans, and establishes a semi-annual schedule for payment of principal and interest on 504 debentures.

II. HEARINGS AND ROUNDTABLES

In the 109th Congress, under Senator Snowe, then chair of the Committee: On March 9, 2006, the Committee held a hearing to examine the SBA's Fiscal Year 2007 budget and the SBA's proposed legislative package for reauthorization. SBA Administrator Hector Barreto provided testimony on the SBA's achievements and its budgetary and programmatic proposals for Fiscal Year 2007. The Administration proposed a funding level of $624 million for the SBA, of which only $425 million was dedicated to the SBA's core programs, and continued the trend of SBA budget cuts. In context, since 2001, the FY 2007 budget request reduced the SBA's budget by 37 percent. During the hearing, the Committee questioned the rationale for the SBA's budget cuts and proposals for essential programs, such as elimination of all three microloan programs and the Administration's proposal to impose administrative fees on the small business participants through programs authorized in Section 7(a) of the Small Business Act, and Section 504 of Title III of the Small Business Investment Act regarding Small Business Investment Companies (SBIC). These proposals were controversial and were not adopted by the Committee.

On April 26, 2006, the Committee held a hearing entitled, "Reauthorization of SBA Financing and Economic Development Programs." The Committee heard from lenders, small business stakeholders, and SBA representatives on the benefits of SBA's credit programs and evaluated reauthorization proposals to improve the broad range of finance programs which play a vital role in assisting America's entrepreneurs in obtaining operating and equity capital.

In the 110th Congress, under the Chairmanship of Senator Kerry: On February 28, 2007, the Committee held a hearing to review the SBA's Fiscal Year 2008 budget. Stephen Preston, the new SBA Administrator, testified. He presented the Administration's budget request of $464 million for the Agency. Of concern to many on the Committee was the proposal to move the SBA's Microloan program to zero subsidy and to eliminate the technical assistance grants for counseling the borrowers. Since 2005, the Administration had proposed the elimination of the Microloan program, and moving to a subsidy model with no technical assistance was considered tantamount to elimination because many intermediaries considered the combination unworkable and therefore would have quit participating in the program. Consequently, the proposal was not well-received by most members of the Committee. The budget did propose fee reductions for SBIC debenture deals and 504 and 7(a) loans, but there was concern that the fee reduction for 7(a) loans would only benefit the lenders and not the borrowers. Also of concern was a recycled proposal to impose a new fee on 7(a) loans sold in the secondary market. The request is controversial because it is viewed as duplicative and premature given that the need is based on an estimate that the payments could run short in ten years, by 2017.

On May 2, 2007, the Committee held a roundtable entitled, “SBA Reauthorization: Small Business Loan Programs.” The purpose of the roundtable was to get feedback on the provisions in S. 3778, and to give members an opportunity to get feedback from the SBA, lending experts, and small business advocates concerning the bill. The roundtable expanded on the public record built as part of the capital reauthorization hearing held in 2006, but focused only on SBA microloans, 7(a) loans, 504 loans, and two pilot programs. Of particular concern was the SBA’s proposal to make the Microloan program zero-subsidy by raising the interest rate on lenders, to eliminate the Microloan technical assistance program, and to require the SBA’s other counseling partners—Small Business Development Centers, Women’s Business Centers, and SCORE—to serve microloan borrowers. For the 7(a) Loan Guaranty program, the debate centered on fees, specifically the authority to reduce fees when there are excess funds to cover the cost of the program, and the implementation of an oversight fee that was authorized as part of the 2005 Omnibus Appropriations Act. The fee reduction language generated debate because the Administration succeeded in making the 7(a) loan program zero subsidy in FY 2005, and the SBA, and certain members of the Committee, oppose any language that would make it possible for the 7(a) loan program to receive appropriations again. There was opposition to the Administration’s implementation of the oversight fee because the industry felt that the fees were excessive and duplicative. There was also concern among Committee staff because the law and final rule went beyond what the Committee had intended and adopted when it considered a similar provision in 2005 as part of S. 1375, the ”Small Business Administration 50th Anniversary Reauthorization Act of 2003.” For the 504 loan program, the trade association for 504 lenders/Certified Development Companies seconded the 7(a) industry’s strong opposition to the imposition of new oversight fees. They also voiced absolute opposition to the SBA’s proposal to move from a bi-annual to a monthly debenture payment schedule out of fear of scaring off investors. Last, the 504 loan representatives argued for raising the real estate appraisal requirement from $250,000 to $750,000. In spite of the SBA’s past opposition to Senator Levin’s Intermediary Lending Pilot program and Senator Kerry’s Child Care Lending Pilot program, the roundtable generated positive discussion of the initiatives. There was also discussion of and support for the creation of an Office of Minority Small Business Development at the SBA to provide leadership within the agency to increase lending, venture capital, counseling, and contracting assistance from the SBA's programs to minority business owners.

On May 22, 2007, the Committee held a hearing entitled, "Minority Entrepreneurship: Assessing the Effectiveness of SBA's Programs for the Minority Business Community." As part of reauthorization, the Committee has tried to address complaints from minority business owners, and organizations representing minorities, that SBA's programs do not effectively meet the needs of these entrepreneurs, and that we need to use these economic development tools to help close the wealth gap between whites and minorities. The Committee discussed the need to increase the share of loans to minorities, which has remained largely stagnant since 2001, to increase the SBIC investments in firms owned by minorities, and to increase the licenses of SBIC funds to minorities.

III. DESCRIPTION OF BILL

Authorization of programs

The Small Business Lending Reauthorization and Improvements Act of 2007, S. 1256, reauthorizes the SBA's non-disaster loan programs for Fiscal Years 2007, 2008, 2009, and 2010, establishing maximum financing levels.

The Microloan programs. The direct Microloan program is reauthorized to leverage $110 million in loans for each of FY 2007, FY 2008, FY 2009, and FY 2010. The guaranty Microloan program is reauthorized to leverage $50 million for each of FY 2007, FY 2008, FY 2009, and FY 2010. Microloan Technical Assistance grants to microloan intermediaries are authorized at the level of $80 million for each of FY 2007, FY 2008, FY 2009, and FY 2010. The Program for Investment in Microentrepreneurs (PRIME) is reauthorized for $15 million for each of FY 2007, FY 2008, FY 2009, and FY 2010.

The 7(a) Loan Guaranty program is reauthorized at levels of $18 billion for FY 2007, $19 billion for FY 2008, $20 billion for FY 2009, and $21 billion for FY 2010.

The 504 Loan Guaranty program is reauthorized at levels of $8 billion for FY 2007, $8.5 billion for FY 2008, $9 billion for FY 2009, and $9.5 billion for FY 2010.

Title I—Microloan programs

The SBA has three programs to support micro-entrepreneurs: the Microloan program, its partner Microloan Technical Assistance program, and the Program for Investment in Microentrepreneurs (PRIME). Under the Microloan program, the SBA makes loans and grants to intermediaries, who then re-loan their loan funds to small businesses, at a maximum $35,000. The lending intermediaries also receive grants from the SBA to provide both pre-loan and post-loan technical assistance to the small businesses and entrepreneurs they serve. This program has proven very effective at serving the needs of minority and women business owners and business owners in rural areas. For example, in FY 2006, the share of microloans to businesses owned by African Americans was 28 percent; by Hispanics was 19 percent; by women was 46 percent; and in rural areas was 33 percent. By comparison, the share of other SBA loans to businesses owned by African Americans ranged from 2 to 7 percent; by Hispanics ranged from 8 to 11 percent; by women ranged from 16 to 23 percent; and in rural areas ranged from 21 to 28 percent.

Further, this program has an excellent track record. Since the first SBA microloan was made in 1992, there has only been one loss to the government. In spite of these facts, the Administration opposes these programs and has proposed eliminating them since FY 2005. The proposals have been rejected each year by Congress. In this year's budget and legislative package, the President modified his proposal. Instead of completely eliminating the Microloan program, he proposed making it zero subsidy by raising the interest rate paid by intermediaries. Specifically, the SBA's proposal sought to increase the interest rate it charges to a microlender for an SBA loan from 2 percent below the five-year Treasury rate to 1.06 percent above the five-year Treasury rate (which would be 5.99 percent in FY 2008). This would increase the interest rate charged to microentrepreneurs to approximately 12–13 percent for a loan from the current rate of approximately 10 percent. As such, many intermediaries reported that they would not be able to participate in the program because while the increase appeared modest, in practice it would be too expensive for the clients they serve. Further, because the five-year Treasury rate fluctuates, if it increased, so would the cost on the intermediaries and the borrowers, making the program even more expensive and therefore even less likely to work.

The SBA also proposed eliminating the microloan technical assistance component and shifting the counseling of borrowers to SBA's other counseling partners, such as the Small Business Development Centers, the Women's Business Centers, and SCORE. The proposal was widely criticized at the SBA's budget hearing on February 28, 2007, and at the roundtable on May 2, 2007, on reauthorization of the SBA's loan programs. Participating in the roundtable were intermediaries from Massachusetts, Maine, and South Carolina. They carry out the program on a day-to-day basis and explained that the proposal was unworkable. They already work with very thin margins, and increased interest rates would make it impossible for many of their clients to afford the loans. They added that they would not make SBA microloans if they were not provided with the funding to provide technical assistance. The technical assistance to the borrower helps them succeed and therefore repay their loan to the intermediary, which makes it possible for the intermediary to repay the SBA. To protect against losses, the program requires each intermediary to put up to 15 percent of their loan funds in a loan loss reserve. It is not reasonable for the Administration to expect the intermediaries to put money into a reserve account and be on the hook for those loans if they are not providing the counseling to their borrowers. Further, the Administration's proposal was considered unreasonable because it would require the SBA's other partners to provide the counseling to the SBA microloan borrowers without providing them with extra funding; the SBA's FY 2008 budget provided no funding to compensate for the extra clientele, and even cut those programs.

Three members of the Committee, Senators Isakson, Enzi, and Bond, opposed the microloan provisions in S. 1256 as introduced because it did not make the SBA Microloan program zero subsidy. While they acknowledged the need for the technical assistance to be provided by the intermediary making the loan, and supported continuing that component of the program, they felt the interest rate increase was modest. Consequently, they filed an amendment to the Chairman's mark, proposing a study by SBA of the Microloan program. However, there was concern about putting SBA in charge of a study to assess the program's effectiveness. Some feared that it would be biased given that the Agency had been trying to eliminate the program for the past four years. As a compromise, Chairman Kerry and Senators Isakson, Enzi, and Bond agreed to include in the Chairman's mark a modification of the amendment, requiring the study to be done by the Government Accountability Office (GAO) instead of the SBA.

In addition to reauthorizing the Microloan program for three years, and rejecting the proposal to make it zero subsidy, the bill includes several provisions that had been adopted by the Committee in the 108th and 109th Congresses. The bill makes a conforming amendment to the Small Business Act to provide microloan intermediaries that have a microloan portfolio with an average loan size of not more than $10,000 the ability to receive a lower interest rate compared to the normal rate extended by the SBA to intermediaries. The statute originally provided that an intermediary had to have an average loan size of not more than $7,500 to receive a reduced interest rate. This bill updates the average and conforms the sections of law that were not raised and should have been.

The bill modifies the eligibility requirements so that an intermediary can qualify to participate in the program if it has an employee with at least three years of making microloans and at least one year of providing intensive marketing, management, and technical assistance providers. Currently, to be licensed as an intermediary, an entity must have at least one year of institutional experience in providing loans to small businesses and at least one year of institutional experience in providing technical assistance to small businesses. As stated when the provision was adopted as part of S. 1375 by the Committee in the 108th Congress, the provision is not intended to lower standards of quality of the entities but rather to permit access for entities that are new to the program and have employees with demonstrated ability and experience, thereby expanding access to the microloan program across the nation.

The bill increases from 25 percent to 30 percent the amount of a technical assistance grant that a microloan intermediary can use to contract out technical assistance to a third party. One incentive that intermediaries have to perform their technical assistance functions well is that the intermediaries must repay their loans to the SBA. The quality of the technical assistance the intermediaries provide to a small business correlates to the success of the business, and a business's ability to repay their loan to an intermediary. Third-party technical assistance providers do not have this concern, as they do not receive direct loans from the SBA and therefore do not put up money in a loan loss reserve to cover losses to the government if a loan goes bad. In the 108th Congress, when the Committee last adopted this provision, there was concern that removing any ceiling on the percent of grant funds that an intermediary could contract out to a third-party provider could harm the program. Those concerned feared that quality of assistance would go down, and with it repayment rates by borrowers and intermediaries. However, the Committee recognized, and continues to recognize, that there is a need for certain technical assistance, like advice on legal, accounting or tax matters, or for specialized industries, which intermediaries are not able to provide directly. Accordingly, this bill provides additional flexibility for intermediaries to contract with third parties.

The bill increases from 25 percent to 30 percent the amount of technical assistance grant funds that an SBA microloan intermediary can use to counsel potential borrowers, instead of actual borrowers. This gives the intermediaries more flexibility in allocating their technical assistance funds, while addressing previous concerns from the Committee that completely eliminating the limit could diminish assistance for those who have taken loans, started businesses, and need the on-going counseling to succeed.

Last, the bill adds persons with disabilities as part of the target population being served by federal microenterprise programs. The Committee has received concerns from participants that although people with disabilities are not being excluded from microenterprise programs, neither are they being specifically targeted or explicitly mentioned as being eligible for receiving assistance. To date, there is no microloan intermediary, PRIME grantee, or Women's Business Center which specifically includes individuals with disabilities. This situation is the result of an unintentional oversight, and not one of purposeful exclusion. This section would raise awareness of this need among microenterprise programs and increase accessibility to such entrepreneurs, while not creating any new programs.

PRIME reauthorization

The Program for Investment in Microentrepreneurs (PRIME) was created in 1999 when the PRIME Act was incorporated and amended in the Gramm-Leach-Bliley Act as part of the U.S. Department of the Treasury's Community Development Financial Institutions Program. At that time, the conferees chose to have the program administered by the SBA. However, the statutory provisions were never moved to the Small Business Act.

The bill reauthorizes PRIME and transfers the statutory language for PRIME to the Small Business Act. PRIME is a program to provide grants to intermediaries that use the funds to: (1) train other intermediaries to develop microenterprise training and services programs; (2) research microenterprise practices; or (3) provide training and technical assistance to disadvantaged entrepreneurs. This section adds a data collection provision and reauthorizes the program at $15 million for Fiscal Years 2007, 2008, 2009, and 2010.

Most of the provisions in this Title originated in the SBA Microenterprise Improvements Act (S. 138), introduced by Senator Kerry on January 24, 2005, and cosponsored by Senators Bingaman and Lieberman. The provisions were included in S. 1375 in the 108th Congress as passed by the Senate, and in S. 3778 in the 109th Congress, as adopted by the Committee.

Title II—Small Business Intermediary Lending Pilot Program

The Committee included in the bill a proposal from Senator Levin to authorize a new three-year pilot program in which the SBA may make loans to local non-profit lending intermediaries, and the intermediaries can then re-loan the funds to small businesses. The program seeks to address the capital needs of start-up and expanding small businesses that require flexible capital but may not be eligible for private or public venture capital. The pilot program is aimed at businesses that desire larger loans than can be provided under the SBA's Microloan program and that, for a variety of reasons, including insufficient collateral, are unable to secure the credit with practicable terms through conventional lenders, even with the assistance of the 7(a) or 504 loan programs.

Through this pilot program, the SBA is authorized to make loans, on a competitive basis, to up to 20 non-profit lending intermediaries around the country. The loans will carry an interest rate of 1 percent, have terms of 20 years, and be capped at a maximum amount of $1 million. Intermediaries will not pay any fees or provide any collateral for their loans. Each 20-year loan will capitalize a revolving loan fund through which the intermediary will make loans of between $35,000 and $200,000 to small businesses. These subordinated-debt loans will be more flexible in collateral and general underwriting requirements than the SBA's other lending programs. In addition, intermediaries will assist their borrowers in leveraging the SBA funds to obtain additional capital from other sources. The pilot will test the impact of this program on job creation in rural and urban areas, especially among under-employed individuals.

Unlike the SBA Microloan Program, the intermediaries will receive no technical assistance grants. All administrative costs or technical support provided to small business borrowers will be covered by the interest-rate spread between the lending intermediary's 1 percent loan from the SBA and the interest rate on loans made to the small business borrowers, the rate for which will be set by the intermediary.

The Small Business Intermediary Lending Pilot Program is modeled after a successful program administered by the U.S. Department of Agriculture (USDA) that has provided loans to non-profit lending intermediaries since 1985. Under that program, no intermediaries have defaulted on their loans from the USDA, which are made at interest rates of 1 percent and have terms of 30 years, and only 2 percent of the intermediaries are currently delinquent on their loans. Unlike the USDA's program, which is limited to rural areas, this pilot will serve both urban and rural regions.

This pilot is designed to reach small businesses that 7(a) lenders will not reach due to the perceived higher risk of these businesses. Many states are fortunate to have a healthy network of community based, non-profit intermediary lenders that are experienced and successful in meeting the needs of small businesses. This pilot program will give them additional tools to stimulate the economy by creating jobs, including jobs for low-income individuals, and facilitate new lending and investing in businesses.

This pilot was originally offered by Senator Levin in the 108th Congress as an amendment to S. 1375. It was accepted by voice vote and passed by the full Senate. In the 109th Congress, it was introduced by Senator Levin as a free-standing bill, S. 416, and then adopted by the Committee as part of S. 3778. In the 110th Congress, it was introduced as S. 985, and then adopted by the Committee as part of S. 1256.

Title III—7(a) loan program

In assessing the 7(a) loan program for reauthorization, the Committee found the program is working well, but there were certain changes that could be adopted which would build on the Committee's reauthorization work of the 109th Congress. Therefore, this bill not only includes the provisions adopted as part of S. 3778, but adds several others. From the last Congress, the bill includes an expanded set of provisions for establishing a national "Preferred Lender Program (PLP)," rather than leaving it to the Administration to develop. The purpose of a national PLP program is to streamline the application process, thereby saving time and money for the SBA and lenders. The PLP program delegates the authority to process, approve, and liquidate loans to lenders that have knowledge of and proficiency in the 7(a) loan program. Currently, to operate nationwide, a lender must apply for PLP status in each of the SBA's 71 districts. Moreover, they must re-apply each year in each district. This is extremely inefficient and wasteful, and creates enormous unnecessary administrative costs.

This provision would drastically reduce administrative costs and standardize the operation of the PLP program, thus eliminating the inefficiencies and costs associated with applying for PLP status in each district. Additionally, the Committee believes that these measures will improve small businesses' access to capital. While the Committee approves of streamlining the application process, it encourages the SBA to continue seeking input from the district directors as part of the approval process in order to try and improve lender oversight. Early in 2007, one of the SBA's largest 7(a) lenders was found by the U.S. Department of Justice to be involved in $76 million in fraudulent SBA loans, with $28 million in loan repurchases out of one district, all linked to one business development officer. By only looking at the lender's national performance, the Agency was unaware that the lender had high repurchases coming out of one district, and therefore was unable to mitigate losses. The Committee does not intend for one district director to have the power to deny or approve the national status, merely to be consulted in an effort to improve lender oversight. The legislative language creating the national PLP was originally included in S.1375, the "Small Business Administration 50th Anniversary Reauthorization Act of 2003," introduced in the 108th Congress by Senator Snowe and Senator Kerry, approved unanimously by the Senate in 2003. It was also adopted by the Committee as part of S. 3778 in the 109th Congress.

The bill increases the maximum size of a 7(a) loan to $3 million from the current $2 million, and increases the maximum size of the accompanying guarantee to $2.25 million from the current $1.5 million. This would maintain the maximum current guarantee rate of 75 percent. With the escalating costs of real estate and new equipment, the Committee believes it is appropriate to respond to small businesses' financing needs by offering larger loans. Further, the Committee expects the SBA to make adjustments to the program's subsidy rate model to reflect the changes because these modifications should help reduce the cost of the program and therefore reduce fees on lenders and borrowers.

To ensure that small firms have adequate capital for working capital purposes, as well as for financing fixed-assets, such as buildings and equipment, the bill allows businesses to receive both the maximum 7(a) and 504 loans. Due to concerns about the risk of allowing maximum loans in both programs to one company, the bill requires the SBA to report annually on volume of loans and to track their specific performance, giving the Committee a tool to assess the effectiveness of the new authority.

To increase interest in the 7(a) loan program of investors who buy loan guarantees sold on the secondary market, the bill gives the SBA flexibility when pooling the loans. Currently, the Agency must pool loans with similar interest rates. This provision will allow the Agency to pool the loans based on a weighted average.

The bill requires the SBA to implement an "alternative size standard" for the 7(a) program, in addition to the program's current standard. The alternative size standard for the 7(a) program would be similar to the standard for the 504 program, which considers a business's net worth and income. The 7(a) program currently determines a small business's eligibility to receive a loan by reference to a complex, multi-page chart that includes different size standards for every industry and focuses on the number of employees. The Committee believes this is cumbersome, especially for small lenders which do not make many 7(a) loans. In the 504 Program, however, lenders can use either the industry-specific standards or an "alternative size standard" the SBA created, which simply says a small business is eligible for a loan if it has gross income of less than $7 million or net worth of less than $2 million. The Committee believes that allowing 7(a) lenders to use this alternative standard, as an option to the industry-specific size standard, would simplify the 7(a) lending process and provide small businesses with a streamlined procedure for determining loan eligibility. Therefore, this would conform the standards used by the 7(a) and 504 programs and would make the program far more accessible to small businesses and small lenders. This provision was included in S. 1375 during the 108th Congress and S. 3778 during the 109th Congress.

To try and achieve the lowest possible interest rate for borrowers, the bill allows the SBA to identify at least one other nationally recognized interest rate to determine the base interest rate for a borrower. Currently, the rates are prescribed as PRIME plus an interest rate of up to 6.5 percent for 7(a) loans. With PRIME up to 8.25 percent, which means an SBA 7(a) loan could have an interest rate as high as 14.75 percent, the Committee encourages the SBA and lenders to identify other market rates which may be more affordable and attractive to small business borrowers.

The bill also creates an Office of Minority Small Business Development to increase the share of small business loans to minorities. The Committee is concerned that African Americans, Hispanics, Asians, and women are receiving far fewer small business loans relative to their share of the population and that there has been no statistically significant improvement since FY 2001. The Office of Minority Small Business Development at the SBA will be similar to offices devoted to business development of veterans and women. In charge of the office will be the Assistant Administrator for Minority Small Business and Capital Ownership Development, under the new title of Associate Administrator for Minority Small Business Development, with expanded authority and an annual budget to carry out its mission. Currently, this position is limited to carrying out the policies and programs of the SBA's contracting programs under Sections 7(j) and 8(a) of the Small Business Act. To ensure that minorities receive a greater share of loan dollars, venture capital investments, counseling, and contracting, this bill expands the Office's authority and duties to work with and monitor the outcomes for programs under Capital Access, Entrepreneurial Development, and Government Contracting. S. 1256 also requires the head of the Office to work with SBA's partners, trade associations, and business groups to identify more effective ways to market to minority business owners, and to work with the head of the Office of Field Operations to ensure that the SBA's district offices have the requisite staff and resources to market to minorities.

The Committee believes it is essential that small exporters nationwide have access to export financing. The bill would improve the current statute that inadvertently has the maximum loan guaranty amount and maximum loan amount working at cross purposes. To help small businesses trade internationally, and provide lenders with a little more incentive than regular SBA 7(a) loans, the bill expands financing to small business exporters by increasing the maximum 7(a) trade loan guarantee amount from $1.75 million to $2.75 million and specifies that the loan cap is $3.67 million. Working capital would also be permitted as an eligible use of loan proceeds. The bill also makes international trade loans consistent with regular SBA 7(a) loans by allowing the same collateral and refinancing terms. This provision originated in the 109th Congress from S. 3663, the "Small Business International Trade Enhancements Act of 2006," introduced by Senator Landrieu on July 14, 2006 and co-sponsored by Senators Bayh, Kerry, and Pryor.

To address on-going complaints to the Committee regarding the Administration's elimination of the 7(a) Low-Doc program, and its harmful impact on lending in rural areas, the bill establishes the Rural Lending Outreach program. This section creates a new 7(a) loan to increase lending in rural areas. The maximum loan is $250,000 and provides incentives for lenders to participate, with an 85 percent guarantee and a requirement of the SBA to process loans within 36 hours. It streamlines 7(a) lending by requiring a short application and minimum documentation, and makes the eligibility requirements on the borrower more flexible. The provision replaces a study that was adopted by the Committee in the 109th Congress to assess whether the elimination of the Low-Doc program was reducing access to capital in rural areas. The Committee concluded that there is a need for an initiative to expand lending in rural areas.

Finally, S. 1256 includes a provision to lower fees on 7(a) borrowers and lenders. The language was the most controversial aspect of this bill, despite the fact that a similar provision passed the full Senate as an amendment to the FY 2006 Commerce, Justice, Science appropriations bill and passed the Committee in July 2006 as part of S. 3778. The provision was intended to address on-going complaints about the Administration taking the program to zero subsidy in FY 2005, which shifted the cost to borrowers and lenders by imposing on them higher fees. The Administration justifies imposing higher fees as a "savings" to taxpayers, while the small business community considers the increase a "tax." The small business community argued that this increase was unfair and unjustified given that the government had continually over-estimated the cost of the program, overcharging borrowers and lenders approximately $900 million since 1992.[1] In fact, since 1992 the government overcharged borrowers and lenders 13 out of 15 years.[2] See chart. For this reason, many in Congress, on both sides of the aisle, opposed the elimination of funding for the program. The bill seeks to address overpayments by requiring the SBA to lower fees if borrowers and lenders pay more than is necessary to cover the program costs or if the Congress appropriates funds, which when combined with collected fees, are in excess of the funding necessary to cover the cost of the program.

[1] GAO Report: "Small Business Administration Section 7(a) General Business Loans Credit Subsidy Estimates," GAO–01–1095R, published August 21, 2001.
[2] "Table 8.—LOAN GUARANTEES: SUBSIDY REESTIMATES," Page 58, Budget of the United States Government, FY 2008, Federal Credit Supplement.

LOAN GUARATEES: SUBSIDY REESTIMATES[1]

(In percentages, unless noted otherwise)

Agency, Bureau, Program, Risk Category, and Cohort Year	Characteristics of Subsidy Reestimates: Original Subsidy Rate	Current Reestimated Rate	Percentage point change due to interest rates	Percentage point change due to technical assumptions	Current reestimate amount[2] ($ thousands)	Net lifetime reestimate amount[3] ($ thousands)	Net lifetime reestimate amount, excluding interest ($ thousands)	Total disbursements to date ($ thousands)
Small Business Administration								
General Business Loan Programs:								
7(a) General Business Loans								
FY 1992	4.85	2.49	0.53	-2.89	-3,045	-155,546	-126,909	5,225,979
FY 1993	5.21	1.80	0.22	-3.56	-3,146	-229,234	-200,086	5,924,899
FY 1994	2.15	0.68	0.04	-1.61	-3,402	-175,560	-113,707	7,192,434
FY 1995	2.74	2.38	0.23	-0.59	-4,194	799	-9,162	7,142,254
FY 1996	1.06	0.95	—	-0.07	-4,276	6,306	-6,732	6,611,630
FY 1997	1.93	0.60	0.30	-1.63	-2,657	-96,776	-105,656	7,887,322
FY 1998	2.14	0.84	-0.91	-0.39	-953	-95,874	-99,968	7,648,894
FY 1999	1.39	1.14	-0.50	0.25	4,361	-12,399	-21,866	8,624,163
FY 2000	1.16	1.51	-0.07	0.42	15,510	52,351	29,609	8,958,110
FY 2001	1.16	1.27	0.05	0.06	31,861	16,669	8,597	8,528,608
FY 2002	1.07	-0.16	0.14	-1.37	9,041	-117,503	-108,385	8,898,273
FY 2003	1.04	0.84	—	-0.40	-18,326	-37,067	-33,033	8,296,066
FY 2004	0.78	0.36	-0.17	-0.25	-56,553	-51,120	-47,535	11,728,569
FY 2005	—	-0.01	-0.06	0.05	-18,018	-848	-260	12,932,252
FY 2006	—	-0.08	—	-0.08	-7,265	-7,265	-6,971	9,062,264

* Nonzero amount rounds to zero, based on units for this column.

[1] Reestimates for some programs did not appear in the 2008 Appendix because they were $500,000 or less. Information on all cohorts is provided in the electronic version of the Federal Credit Supplement at www.budget.gov/budget/

[2] Current year reestimates, including interest on reestimates.

[3] Total (net cumulative) reestimates, including interest on reestimates.

[4] Breakout between technical and interest reestimates is not available.

[5] Reestimates have not yet been calculated.

[6] Includes the SLS loan program, for which loans were last originated in 1994.

[7] The SMG program was brought on budget as subject to the Federal Credit Reform Act in 2004. The 2004 cohort includes activity for all cohorts prior to and including 2004.

This language makes it possible to reduce fees for borrowers and lenders and corrects a drafting error. The original language adopted in the FY 2005 Omnibus Appropriations Act is deficient because it requires the fees to always be set at a level for zero subsidy. Even if Congress restored appropriations to the 7(a) loan program these funds could not be applied towards reducing the fees. This provision corrects this error. The language in S. 1256 is somewhat changed from the version adopted in the 109th Congress; it includes a limitation on the amount of appropriations that can be used to reduce the fees—to not more than the average of the overestimates of the three most recent years. This provision was added as a compromise between Chairman Kerry and Senators Isakson, Enzi, and Bond. Senators Isakson, Enzi, and Bond had filed an amendment to the chairman's mark that eliminated the reference to appropriations because they oppose any attempt to open the program back up to appropriations. Nevertheless, they agreed that it was important to try and reduce program fees when the government overcharges participants, as has happened routinely since 1992. The bill adopts a modified version of their amendment with that limitation.

Many of the provisions in this Title were adopted as part of S. 3778 in the 109th Congress. They originated in the Small Business Lending Improvement Act (S. 1603), introduced by Senator Snowe in July 2005 and cosponsored by Senator Stevens, and in the 7(a) Loan Program Reauthorization Act of 2006 (S. 2594), introduced by Senator Kerry in April 2006 and cosponsored by Senators Landrieu and Pryor.

Title IV—Certified development companies; 504 Loan program

The purpose behind most of the 504 Loan Guaranty program changes was to address concerns that some certified development companies (CDCs) have started to act more like banks than nonprofits, seeking to expand wherever they see a deal without reinvesting the residual income from 504 loans back into the development of the relevant local community and economy.

To more accurately reflect the purposes of the SBA's 504 Loan Guaranty program, the bill changes the name of the program to the Local Development Business Loan Program (LDB Program). Materials already prepared using the name "504 Program" can continue to be used, so as to save money for the SBA and program participants.

To provide more flexibility to the program, the bill provides that a CDC is not required to foreclose or liquidate its own defaulted loans, and may contract with a third party to process its foreclosures and liquidations. CDCs may also receive reimbursement from the SBA for foreclosure expenses that the SBA authorizes.

To reduce costs on growing small businesses, the bill allows certain borrowers (start-ups or those using the proceeds for single purpose buildings) to contribute more equity/down-payments to a project. This change makes it possible for the borrower to use their excess investment to reduce the amount of the private bank loan, thereby reducing their costs because the bank portion of a loan typically carries less favorable terms than the CDC portion of the loan.

To make SBA's two largest loan programs more user friendly, the bill makes uniform the leasing policy for projects financed by 7(a) and 504 loans.

To encourage businesses to locate in low-income areas, the bill adds several incentives to the 504 loan program. It provides that businesses in communities that would qualify for a New Markets Tax Credit can qualify as "public policy goal" loans in the 504 loan program are therefore eligible for larger loan guarantees of $4 million instead of the $2 million guarantee that is available for non-public policy goal loans. This would be similar to the special incentive for manufacturers, which allows for a maximum 504 loan of $4 million maximum. As another incentive, this section would increase the SBA size standards issued by regulation to determine eligibility for a 504 loan in such areas. The amount of the proposed increase would be 25 percent and would apply to all standards, whether based upon the business' number of employees or annual sales. It would also apply to an alternative size standard for CDC financing, which is based upon the net income and net worth of the business. This change is similar to the special incentive used by the Department of Labor to encourage businesses in Labor Surplus Areas that increases size standards by 25 percent. Last, the section would increase the amount of personal liquidity or assets which an owner of a business may retain before being required to inject additional capital into a 504 project in order to reduce the amount needed from SBA. The exemption would be increased by 25 percent for loans in areas eligible for New Market Tax Credits.

For the purposes of qualifying as a public policy goal loan, this bill allows businesses to qualify as "minority owned" if a majority of the business's ownership interests belong to one or more individuals who are minorities. Currently, the SBA interprets this rule such that two or more minorities cannot aggregate their interests (for example, two out of three owners) to qualify the business as minority owned.

The bill permits a borrower to refinance a limited amount, based upon a formula, of the business's pre-existing debt, if that debt is already secured by a mortgage on the property being expanded by the new loan.

The bill corrects a technical drafting error made in legislation enacted in 2004. That drafting error had inadvertently changed the meaning of the pre-existing Small Business Investment Act of 1958, which governs the 504 loan program.

The repeal of the sunset provisions regarding reserve requirements for Premier Certified Lenders would make permanent a temporary statute that would otherwise have expired in the summer of 2006. This statute, enacted by Congress on a trial basis in 2004, allows CDCs qualified by the SBA as "Premier Certified Lenders" to amortize their reserve requirements and withdraw from the reserves the amount attributable to debentures as the debentures are re-paid. CDCs that choose to employ this new ability are thus able to make a greater number of loans in the program, rather than having needlessly large reserve accounts.

The current Small Business Investment Act of 1958 (SBIA), which provides the legislative authority for the program, does not define a CDC; it is defined only in the SBA's regulations. To address that, the bill provides definitions of a "development company" and a "certified development company." It also provides a number of criteria to identify the types of entities that can qualify as CDCs and thus participate in the LDB Program. The standards in this Act are consistent with current regulations. In addition, the bill also imposes ethical requirements on CDCs, their employees, and banks participating in the program. It provides minimum requirements for CDCs regarding members, boards of directors, staffing and management expertise, and use of proceeds. The bill details requirements CDC loan review committees must meet in order to ensure that CDCs pursue local development goals, and allows CDCs operating in multiple states to elect to maintain their accounting on an aggregate basis.

Responding to concerns that the changes which have allowed CDCs to expand operations into multiple states have had a significant impact on the 504 program, the Committee included provisions to preserve the local community and economic development intent and mission of the program and to provide increased accountability. There has been a growing demand for 504 loans and many CDC operations have been expanding in response to this growth. The 504 program was not created for CDCs to merely generate revenue from one state to another. CDCs are more than lenders and should not act like for-profit banks. In order to further responsible CDC expansion, program growth, and increased access to capital for small business, while requiring that local communities continue to be the main focus of the program, the bill requires that the 25 members of the CDC board be residents of the area of operations. It also allows an individual to serve on the Board of Directors of two or more CDCs (but not serve as an officer of multiple CDCs), and removes regulatory barriers that have constrained CDC multi-state expansion. The bill allows borrowers the option to include loan and debenture closing costs in their loans.

To simplify use of the 504 program and encourage CDCs to make loans to businesses in rural areas, the bill amends the definition of "rural" in the Small Business Investment Act of 1958 to match the definition used by the U.S. Department of Agriculture. Specifically, it is defined as an area other than a city or town with a population greater than 50,000 inhabitants, or the urbanized area contiguous and adjacent to such a city or town, would qualify. This will benefit the small businesses because development in a rural area qualifies as one of the public policy goals of the 504 program and allows such businesses to qualify for larger loans of $2 million, instead of $1.5 million.

The bill includes a provision to lock in place the payment schedule for debentures at twice a year rather than monthly. The SBA proposed a monthly schedule at the roundtable on May 2, 2007, and it received sharp criticism from the National Association of Development Companies. They feared it would scare off investors and drive up the cost of the program.

The bill includes a provision to increase from $250,000 to $400,000 the trigger for mandating a real estate appraisal. The industry requested the cap be increased to $750,000, but the Administration thought this level would expose too much risk.

The provisions in this subtitle originated in the Local Development Loan Program Act (S. 2162), introduced by Senator Snowe in December 2005, and in the 504 Loan Program Modernization Act of 2006 (S. 2595), introduced by Senator Kerry in April 2006, and co-sponsored by Senator Pryor. Most were adopted by the Committee as part of S. 3778 in the 109th Congress.

Child Care Lending Pilot Program

Title IV includes the creation of the Child Care Lending Pilot program to allow small non-profit child-care providers to receive 504 loans. This initiative is the product of work from the 107th, 108th, and 109th Congresses, including roundtables on May 1, 2003 and May 2, 2007.

This pilot program responds to the shortage of affordable child care and the need for financing to expand and upgrade facilities by enabling lenders to make 504 loans to qualifying non-profit child-care providers. Currently, 504 loans can be made to for-profit child-care providers. The pilot program would be available through Fiscal Year 2010.

During the roundtable on On May 1, 2003, Ms. Julie Cripe, President and CEO of Omnibank in Texas, and Ms. Ardith Wieworka, Commissioner of the Massachusetts Office of Child Care Services, explained why as a lending expert and as an expert on child care facilities, the Congress should allow non-profit child care providers to be eligible for 504/CDC loans. It was noted that there is a shortage of affordable child care in the United States, with an estimated six million children left at home on a regular basis, according to the Census Bureau. During the roundtable on May 2, 2007, Ms. Joan Wasser Gish, Principal of Policy Progress in Massachusetts, presented the conclusions of a year-long Child Care Small Business Initiative lead by the office of Senator Kerry. The initiative included a statewide advisory committee, with a cross-section of stakeholders from the early education and child care industry, as well as, among others, representatives from the U.S. Small Business Administration's Massachusetts District, the Massachusetts Small Business Development Centers, SBA 504 lenders, the Center for Women and Enterprise, and SBA microlenders. The committee found that there is a "dearth of lending and other financial resources available to nonprofit child care centers," and that the lack of child care had broader economic ramifications of "inhibiting economic growth and productivity, community development, and work availability and productivity." Wasser Gish noted that the child care industry plays a vital role in supporting private enterprise and free competition: "There are 5.8 million small business that hire employees, and many of those hires are parents who are unable to work [because] of the availability of child care. . . . It is estimated that child care breakdowns leading to employee absences cost the United States businesses in excess of $3 billion annually." She also cited a 2006 study from the State of Maine that found "an urgent need" for improving the quality of child care facilities, with more than 70 percent of the centers in Maine barred from getting accreditation because of their facilities. Wasser Gish emphasized the need for 504 loans to help these centers finance upgrades and expansion because child care providers are prohibited from using their child care development block grant funding for capital expenditures.

While most of SBA's loan programs are not designed to serve non-profit entities, making SBA loans to non-profits is not unprecedented and many members of the Committee believe that non-profit child-care providers warrant special consideration because the shortage is so severe in many states and the industry is unique. For example, in order to qualify for certain types of Federal assistance for low income families, such as meal assistance, a child-care provider may be required to organize as a non-profit, rather than a for-profit, entity, which can have a negative impact on the entity's ability to obtain necessary capital. Whereas most service industries are made up of for-profit businesses, in many states a significant portion of child care is delivered through non-profits, and in the neediest communities non-profits are often the only child-care providers. Further, entrepreneurs and employees, particularly women, often cite a lack of child care for their children as a substantial obstacle to their ability to be more actively involved in the small business sector of the economy.

As referenced earlier, permitting non-profit child-care providers to participate in the 504 program is not completely unprecedented. The SBA's Microloan program has permitted loans to be made to non-profit child-care providers since 1997, and the SBA's physical disaster loan program makes loans to non-profits, such as religious entities. Further, as part of the SBA's FY 2008 legislative package, the Administration proposed expanding lending to non-profits by seeking authority to make economic injury disaster loans to non-profits.

The Committee stresses, however, that it does not intend to expand the SBA's loan programs to other types of non-profit entities in the future. The fundamental purpose of the SBA is to foster profitable small businesses and the entrepreneurs who start them. In order to ensure that this pilot program does not impede the ability of for-profit businesses to access capital through the 504 loan program, the bill limits the pilot program to 7 percent of the number of 504 loans guaranteed in any year. Currently, less than 2 percent of 504 loans are made to for-profit child-care providers.

As another protection, the bill requires collateral provided for a loan be owned directly by the child-care provider. This provision addresses a fear that, in some circumstances, 504 loans to certain non-profit child-care providers could be based on collateral that may be difficult for the lender to access. Going a step further, the bill requires the loan to be personally guaranteed and requires the borrower to have sufficient cash flow from its normal operations to both make its loan payments and pay for customary operating expenses. As an oversight protection, the bill directs the GAO to provide to Congress a comprehensive report analyzing the pilot program, as the program nears the end of its three-year pilot period.

During the Committee's consideration of S. 1256, Senators Isakson, Enzi, and Bond filed an amendment to the Chairman's mark to eliminate the pilot and to instead mandate a study on the state of child care from the GAO. However, studies in Massachusetts and Maine, as noted earlier in this section, have already demonstrated a need for expanded and upgraded child care facilities and the lack of capital to help them finance the projects language. As a compromise, Chairman Kerry and Senators Isakson, Enzi, and Bond modified the amendment and agreed to limit the pilot to only 19 states, those of the members of the Committee. The amended pilot passed the Committee unanimously as part of the entire bill.

The Child Care Lending pilot program was adopted by the Committee in the 108th and 109th Congresses and was voted out of the full Senate in the 108th. The pilot has many supporters, including the National Black Chamber of Commerce, the National Association of Development Companies, and representatives of child development in Maine and in Massachusetts.

IV. COMMITTEE VOTE

In compliance with rule XXVI(7)(b) of the Standing Rules of the Senate, the following votes were recorded on May 16, 2007.

A motion by Senator Kerry to adopt the managers' substitute amendment was passed by voice vote. The amendment included modified versions of three amendments filed by Senators Isakson, Enzi, and Bond regarding the reduction of 7(a) loan fees, the Child Care Lending Pilot program, and the Microloan program.

A motion by the Chair to adopt the Small Business Lending Reauthorization and Improvements Act of 2007 as amended, to reauthorize the small business loan programs of the Small Business Administration and for other purposes, was approved by a unanimous 19–0 recorded vote with the following Senators voting in the affirmative: Kerry, Levin, Harkin, Lieberman, Landrieu, Cantwell, Bayh, Pryor, Cardin, Tester, Snowe, Bond, Coleman, Vitter, Dole, Thune, Corker, Enzi, and Isakson.

V. COST ESTIMATE

In compliance with rule XXVI(11)(a)(1) of the Standing Rules of the Senate, the Committee estimates the cost of the legislation will be equal to the amounts discussed in the following letter from the Congressional Budget Office.

SEPTEMBER 10, 2007.

Hon. JOHN F. KERRY,
Chair, Committee on Small Business and Entrepreneurship,
U.S. Senate, Washington, DC.

DEAR MR. CHAIR: The Congressional Budget Office has prepared the enclosed cost estimate for S. 1256, the Small Business Lending Reauthorization and Improvement Act of 2007.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Susan Willie.

Sincerely,

PETER R. ORSZAG.

Enclosure.

S. 1256—Small Business Lending Reauthorization and Improvements Act of 2007

Summary: S. 1256 would reauthorize the business and disaster loan programs of the Small Business Administration (SBA) through 2010. The bill also would make technical changes to the SBA's business loan programs, authorize two pilot loan programs, and reauthorize a grant program to support minority entrepreneurs. Finally, the bill would authorize SBA to use appropriated funds, with limits, in lieu of charging fees to cover the cost of 7(a) loan guarantees.

Assuming appropriation of the necessary amounts, CBO estimates that implementing S. 1256 would cost $487 million in 2008 and $3.4 billion over the 2008–2012 period. About $1.8 billion of this amount is the estimated subsidy and administrative cost of continuing SBA's credit programs, and about $1.6 billion would be for SBA's noncredit programs and other activities authorized in the bill. CBO estimates that enacting the bill would not affect revenues and would have no significant effect on direct spending.

S. 1256 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA). The bill would authorize grant funds that could benefit tribal governments. Any costs they might incur would result from complying with conditions of federal assistance.

Major provisions: Title I would make technical changes to the microloan program, which provides funding to companies whose capital needs are too small to qualify for the larger SBA business loan programs. Title I also would reauthorize the Program for Investment in Microentrepreneurs (PRIME).

Title II would create an Intermediary Lending Pilot Program, modeled after the microloan program, to provide midsize loans to small businesses. Under the pilot program, loans made to small businesses would range between $35,000 and $200,000.

Title III would make a number of changes to the 7(a) loan guarantee program, including: creating a preferred lenders program, which would authorize certain lenders to make and service loans; increasing certain loan limits for 7(a) guarantees; and establishing a program to increase loans available in rural areas. This title also would authorize SBA to lower fees charged to borrowers and lenders for 7(a) loan guarantees under certain conditions and establish an Office of Minority Small Business Development.

Title IV would make changes to SBA's 504 loan program, which provides loans through Certified Development Companies (CDCs) for investments in major fixed assets. S. 1256 would change the name of the program to the Local Development Business Loan Program, allow CDCs to contract with third parties to foreclose and liquidate defaulted loans, and adjust eligibility requirements to encourage investment in low-income areas. This title also would establish a pilot program that would authorize CDCs to make loans to nonprofit child care businesses in a limited number of states.

S. 1256 also would set the maximum amount of loans and loan guarantees that could be funded by SBA for fiscal years 2008, 2009, and 2010. In addition, it would provide specific authorizations of appropriations for the PRIME program and technical assistance grants for microloan recipients. Finally, the bill would authorize appropriations of such sums as may be necessary for salaries and expenses of the SBA, administrative expenses and loan capital for the disaster loan program, and administrative expenses and subsidy costs to carry out the Small Business Investment Act.

Estimated cost to the Federal Government: The estimated budgetary impact of S. 1256 is shown in the following table. The costs of this legislation fall within budget functions 370 (commerce and housing credit) and 450 (community and regional development).

TABLE 1.—ESTIMATED BUDGETARY IMPACT OF S. 1256

	By fiscal year, in millions of dollars—					
	2007	2008	2009	2010	2011	2012
SPENDING SUBJECT TO APPROPRIATION						
SBA spending under current law:						
Budget authority [1]	492	0	0	0	0	0
Estimated outlays	357	95	23	5	0	0
Proposed changes:						
Loan programs:						
Estimated authorization level	0	434	435	441	268	275
Estimated outlays	0	277	400	430	349	283
Noncredit programs:						
Estimated authorization level	0	386	394	402	310	318
Estimated outlays	0	210	310	368	382	365
Total:						
Estimated authorization level	0	820	829	843	578	593
Estimated outlays	0	487	710	798	731	648
SBA spending under S. 1256:						
Estimated authorization level [1]	492	820	829	843	578	593
Estimated outlays	357	582	733	803	731	648

[1] The 2007 level is the amount appropriated for that year.

Basis of estimate: For this estimate, CBO assumes that the bill will be enacted near the end of fiscal year 2007 and that the necessary amounts will be appropriated near the start of each year. We assume that spending will follow historical patterns for the various SBA loan and business assistance programs.

The budgetary accounting for SBA's direct loan and loan guarantee programs is governed by the Federal Credit Reform Act (FCRA) of 1990, which requires an appropriation of subsidy and administrative costs associated with loan guarantees and loan operations. The subsidy cost is the estimated long-term cost to the government of a loan or loan guarantee, calculated on a net-present-value basis, excluding administrative costs. Administrative costs, recorded on a cash basis, include activities related to making, servicing, and liquidating loans as well as overseeing the performance of lenders.

The effect of the changes S. 1256 would make to SBA's business and disaster loan programs is measured in terms of projected subsidy costs. The bill does not specify an authorization level for either the subsidy or administrative costs, if any, that could be incurred as a result of implementing the amendments in the bill. CBO has estimated those amounts based on information from SBA regarding the historical demand for and costs of the agency's business and disaster loan programs. We assume that administrative activities related to those loans would continue beyond the 2008–2010 period.

Spending subject to appropriation

S. 1256 would authorize SBA to continue its direct loan and loan guarantee programs as well as various technical assistance and support programs for fiscal years 2008 through 2010. Based on information from SBA and historical spending patterns for the agency's programs, CBO estimates that implementing those provisions would cost $3.4 billion over the 2008–2012 period, assuming appropriation of the necessary amounts.

Table 2 shows the loan levels that would be authorized by the bill, the estimated subsidy and administrative costs for those loans, and the cost to continue certain grant programs and other activities authorized by the bill.

Guaranteed and Direct Business Loan Programs. The following loan programs would be authorized by S. 1256:

- The 7(a) program, which provides limited guarantees on loans made by certain lending institutions to small businesses.
- The certified development company program (also known as section 504 loans), which provides guarantees on debentures issued by CDCs to provide funding to small businesses for major fixed assets such as land, structures, machinery, and equipment.
- The microloan program, which provides direct loans to nonprofit lenders which then offer loans to small businesses just starting up, whose capital needs are too small to qualify for the 7(a) program.
- The Small Business Investment Company (SBIC) debenture program, which provides funding to privately owned companies that provide venture capital to small businesses.

TABLE 2.—ESTIMATED SUBSIDY, ADMINISTRATIVE, AND OTHER NONCREDIT COSTS UNDER S. 1256

	By fiscal year, in millions of dollars—				
	2008	2009	2010	2011	2012
Guaranteed and direct business loan subsidy and administration costs:					
Subsidy costs:					
Estimated authorization level	13	13	13	0	0
Estimated outlays	7	12	12	6	0
Administration costs:					
Estimated authorization level	127	131	135	138	142
Estimated outlays	90	121	129	134	138
Lower 7(a) fees:					
Subsidy costs:					
Estimated authorization level	8	2	0	0	0
Estimated outlays	5	4	1	0	0
Small business intermediary lending program:					
Estimated authorization level	3	3	3	0	0
Estimated outlays	1	3	3	1	0
Disaster loan subsidy and administration costs:					
Subsidy costs:					
Estimated authorization level	163	163	163	0	0
Estimated outlays	82	146	163	82	16
Administration costs:					
Estimated authorization level	120	123	127	130	133
Estimated outlays	92	114	122	126	129
Noncredit programs and costs PRIME program:					
Estimated authorization level	17	17	17	0	0
Estimated outlays	1	6	13	15	10
Other noncredit programs and costs:					
Estimated authorization level	369	377	385	309	318
Estimated outlays	209	304	355	367	355
Memorandum:					
Authorized loan levels:					
Guaranteed and direct business loans	31,167	32,667	34,167	0	0
Disaster loans	1,000	1,000	1,000	0	0

The bill would authorize SBA to guarantee loans and to make direct loans to small businesses, with a total loan value up to $31 billion in 2008, $33 billion in 2009, and $34 billion in 2010. By comparison, the authorized loan level for 2007 is about $28 billion. In 2006, the agency's authorized loan level was about $28 billion, and it funded direct and guaranteed loans worth about $20 billion in that year.

The estimated subsidy rates for the business loan programs offered by SBA range from zero for 7(a) and section 504 programs to about 10 percent for the microloan program. Incorporating the program amendments in the bill and using historical demand and default rates for those loan programs, CBO estimates that the subsidy costs for the authorized levels of guaranteed and direct business loans would be $7 million in 2008 and about $37 million over the 2008–2012 period.

As specified in FCRA, subsidy rates do not reflect the administrative costs to service loan programs. CBO estimates the administrative costs for the business loans authorized in the bill would be $90 million in fiscal year 2008 and $612 million over the 2008–2012 period.

Lowering 7(a) fees. S. 1256 would authorize SBA to use appropriated funds, if available and within limits, to lower certain fees charged to cover the estimated cost of loans guaranteed through the 7(a) program. The maximum annual fee reduction set by the bill would equal the average amount, over the previous three fiscal years, that fee collections have exceeded the cost of the underlying loan guarantees.

Under current law, SBA develops a schedule of fees to be charged to both borrowers and lenders each fiscal year to produce an estimated subsidy rate of zero when the loans are guaranteed. In other words, each year SBA sets fees at the rate, in its estimation, that will generate collections equal to the estimated lifetime cost of providing the loan guarantees. Each year, SBA guarantees a growing number of 7(a) loans (over 90,000 in 2006); the net cost of those guarantees cannot be calculated until all the loans are closed out. At that point, SBA can determine if the fees charged were sufficient to cover the long-term cost of the guarantees—it is not until the loans are closed out that SBA can know whether fee collections were too high or too low.

The projected subsidy cost for the 7(a) program in 2008, in the absence of fees, would be about 3.4 percent of the loan principal guaranteed, or about $305 million. Over the 2004–2006 period, SBA reduced its estimate of the cost of 7(a) loan guarantees, indicating that in the early years of the loans, the cost of providing the guarantees was lower than SBA originally estimated. As those loans age, however, the guarantees could become more costly.

Assuming appropriation of the maximum amount authorized by S. 1256 for reducing fees on the 7(a) program, CBO estimates that implementing this provision would cost $5 million in 2008. That estimate is the average amount of fees collected above the amounts SBA estimates would be necessary to fully offset the cost of guarantees over the fiscal year 2005–2006 period. We assume that SBA will set fees in subsequent years equal to the program's costs, thereby lowering the maximum amount available to reduce fees in each year. We estimate that this provision would cost $10 million over the 2008–2012 period.

Small Business Intermediary Lending Program. The bill would authorize a three-year program to provide up to $20 million in loans, ranging in size from $35,000 to $200,000, to nonprofit lenders over the 2008–2010 period. The Small Business Intermediary Lending Pilot Program would make direct loans to nonprofit intermediaries that would, in turn, make loans to eligible small businesses. The program, modeled after the microloan program, would feature a 20-year loan term, an interest rate of 1 percent, and a two-year grace period before principal and interest payments would be first due. Based on information from the SBA, CBO estimates that the subsidy rate for the program would be about 38 percent, largely due to the difference between the government's borrowing rate and the rate SBA would charge the borrowers. We estimate that the subsidy cost for the authorized loan amounts would be $8 million over the 2008–2012 period.

Disaster Loan Program. S. 1256 would reauthorize SBA's disaster loan program through 2010. This program provides direct loans to businesses and households in areas affected by a disaster for the costs of economic injury and repair. CBO expects that the demand for SBA disaster loans over the next several years would average about $1 billion per year. This assumption is based on the historical average of approved disaster loans over the 2000–2005 period, including an additional amount reflecting the probability that a catastrophe similar to Hurricane Katrina could strike in a given year.

Based on historical experience, SBA estimates that the subsidy rate for those loans would be about 16 percent. Using that rate and assuming the appropriation of the necessary funds, CBO estimates that reauthorizing the disaster loan program through 2010 would cost $174 million in 2008 and about $1.1 billion over the 2008–2012 period. This estimate includes $489 million over the five-year period for the cost of subsidizing those loans and $583 million over the same period for loan service and administration.

PRIME reauthorization. S. 1256 would authorize the Program for Investment in Microentrepreneurs (PRIME) through 2010. This program disburses grants to certain development organizations to provide very small businesses (microenterprises) with technical assistance, training, and capacity building services. Assuming appropriation of the specified amounts, CBO estimates that this provision would cost $45 million over the 2008–2012 period.

Other noncredit activities. S. 1256 would authorize specific amounts or such sums as necessary for the salaries and expenses of SBA and several programs to support certain types of small businesses. Based on information from SBA, CBO estimates that implementing those provisions of S. 1256 would cost $209 million in 2008 and about $1.6 billion over the 2008–2012 period, assuming appropriation of the specified or necessary amounts.

Specifically, the bill would authorize grants to nonprofit lenders participating in the microloan program to provide technical assistance to borrowers who receive loans under the program. Assuming appropriation of the specified amounts, CBO estimates this provision would cost $4 million in 2008 and $207 million over the 2008–2012 period.

The bill also would authorize $5 million per year over the 2008–2010 period to establish the Office of Minority Small Business Development to increase the proportion of SBA loans, investments, training, and contracting opportunities directed toward minorities. Assuming appropriation of the specified amounts, CBO estimates this provision would cost $15 million over the 2008–2012 period.

Salaries and expenses for SBA employees, other than those involved in the administration of direct loans and loan guarantees, make up the balance of the cost. CBO estimates that the cost to support grant administration, advocacy, and entrepreneurial programs would be about $200 million in 2008 and $1.4 billion over the 2008–2012 period.

Direct spending

SBA's Premier Certified Lenders Program gives a CDC participating in the 504 program the authority to review and approve loan requests and to foreclose, litigate, and liquidate loans made under the program. Under current law, CDCs can qualify as Premier Certified Lenders (PCLs) if, among other requirements, they agree to pay 10 percent of SBA's potential loss on a defaulted 504 loan. A PCL must hold 10 percent of this potential loss (that is, 1 percent of the total loan) in a reserve for the life of the loan.

S. 1256 would reinstate a program that allows PCLs to maintain a lower loss reserve equal to 1 percent of the total loan outstanding. PCLs would be allowed to withdraw any funds from their loss reserve in excess of this amount. This lower loss reserve option was previously authorized for two years; it expired in 2006. S. 1256 would reinstate the option permanently, which could affect the subsidy rate for previous cohorts of CDC loans. Decreasing the loss reserve requirement for PCLs would cause SBA to collect a smaller amount of recoveries if a small business defaults on a loan and a PCL is unable to pay its portion of SBA's total loss. Based on information from SBA, CBO estimates that this provision would not have a significant effect on the subsidy cost of outstanding loans.

Intergovernmental and private-sector impact: S. 1256 contains no intergovernmental or private-sector mandates as defined in UMRA. The bill would authorize grant funds that could benefit tribal governments. Any costs they might incur would result from complying with conditions of federal assistance.

Previous CBO estimate: On April 19, 2007, CBO transmitted a cost estimate for H.R. 1332, the Small Business Lending Improvements Act of 2007, as ordered reported by the House Committee on Small Business on March 15, 2007. That bill contained many of the same technical changes to SBA's 7(a) and 504 programs but did not provide maximum loan levels for the various business loan programs. H.R. 1332 also would authorize SBA to use appropriated funds rather than charging certain fees on loans guaranteed under the 7(a) program to cover the program's cost. CBO provided an estimate of the cost—$2.3 billion over the 2008–2012 period—to fully replace such fees with appropriated funds.

Estimate prepared by: Federal Costs: Susan Willie and Daniel Hoople; Impact on State, Local, and Tribal Governments: Elizabeth Cove; Impact on the Private Sector: Jacob Kuipers.

Estimate approved by: Peter H. Fontaine, Assistant Director for Budget Analysis.

VI. EVALUATION OF REGULATORY IMPACT

In compliance with rule XXVI(11)(b) of the Standing Rules of the Senate, it is the opinion of the Committee that no significant additional regulatory impact will be incurred in carrying out the provisions of this legislation. There will be no additional impact on the personal privacy of companies or individuals who utilize the services provided.

VII. SECTION-BY-SECTION ANALYSIS

Title I—Microloan Programs

Sec. 101. Conforming technical change in average smaller loan size

This section increases the average loan size from $7,500 to $10,000 in places in the Small Business Act where the size should have been changed as part of PL 106–554 but was not. Microloan intermediaries can receive additional technical assistance grants from the SBA for making microloans of smaller average sizes, loans that typically require more counseling and therefore are more expensive to service.

Sec. 102. Inclusion of persons with disabilities

This section adds individuals with disabilities to the statutorily enumerated "purposes" of the program, clarifying that microloans can be made to such individuals. It does not change the implementation of the program.

Sec. 103. Microloan program improvements

(a) Intermediary eligibility requirements. This subsection modifies the eligibility requirements so that an intermediary can qualify to participate if it has an employee with at least three years of experience making microloans and at least one year of experience providing intensive marketing, management and technical assistance to borrowers.

(b) Limitation on third party technical assistance. This subsection increases from 25 to 30 percent the amount of technical assistance funds an intermediary may use to pay for hiring outside expertise to counsel borrowers, such as with taxes or specialists in a particular industry.

(c) Increased flexibility for providing technical assistance to potential borrowers. This subsection increases from 25 to 30 percent the amount of technical assistance that intermediaries can provide to potential borrowers, versus those that get loans and need on-going counseling.

Sec. 104. PRIME reauthorization and transfer to the Small Business Act

This subsection transfers the authorization of this program from the Riegle Act to the Small Business Act, clarifying that the program should be administered by the SBA, as defined in the original legislation that created the program. Of the money designated for this program, which provides technical assistance to micro-entrepreneurs, the section authorizes additional funds to serve Native Americans.

Title II—Intermediary Lending Pilot Program

Sec. 201. Findings

Sec. 202. Small business intermediary lending pilot program

This section creates a pilot program for the SBA to provide loans to intermediaries, which would then re-loan these funds to small businesses in loan amounts between $35,000 and $200,000. They would have terms of 20 years, at 1 percent interest rate. The intermediaries would not have to start paying back the loan for the first two years. The purpose of the pilot is to assist small businesses that need loans larger than those available through the Microloan program, but, for a variety of reasons, such as a lack of sufficient collateral, are unable to secure financing through conventional lenders, even with the assistance of the 7(a) Loan and 504 Loan Guaranty programs.

Title III—7(a) Loan Program

Sec. 301. Preferred lenders program

This section establishes a program for proficient 7(a) lenders that delegates to them the authority to approve and liquidate 7(a) loans. This section also establishes a streamlined national preferred lender program, which allows lenders with a good track record to operate nationwide without having to seek approval from each of the SBA's district offices.

Sec. 302. Maximum loan amount

This section increases the maximum loan to $3 million from $2 million, and increases the maximum accompanying guarantee from $1.5 million to $2.25 million.

Sec. 303. Maximum 504 and 7(a) loan eligibility

This section permits a small business to obtain financing in the maximum amount permitted under the 504 program and also to obtain a 7(a) loan in the maximum amount permitted under that program.

Sec. 304. Loan pooling

This section allows the SBA to pool loans with various interest rates, with the range determined by SBA. The interest rate on the certificates representing shares in the pool would be the weighted average rate. Currently SBA pools loans with the same interest rates to sell on the secondary market.

Sec. 305. Alternative size standard

This section requires SBA to establish an optional size standard which is applicable to both 7(a) borrowers and 504 borrowers, utilizing net worth and net income in lieu of industry standards, which are considered confusing and burdensome. In addition, it provides that until the Administrator does so, the alternative standard in the Code of Federal Regulations for 504s (maximum net income of $7 million and maximum net worth of $2.5 million) shall also apply to 7(a).

Sec. 306. Alternative variable interest rate

This section directs the SBA to give lenders at least one alternative interest rate to the Wall Street prime rate. The provision is intended to reduce the variable interest rate charged on 7(a) loans to borrowers.

Sec. 307. Minority small business development

This section creates an Office of Minority Business Development within the SBA. This provision expands the Office's authority and duties to work with and monitor the outcomes for programs under the SBA's Capital Access, Entrepreneurial Development, and Government Contracting programs. It also requires the head of the Office to work with SBA's partners, trade associations, and business groups to identify more effective ways to market to minority business owners, and to work with the head of Field Operations to ensure that district offices have staff and resources to market to minorities.

Sec. 308. Lowering of fees

This section revises the current statute so that, if SBA receives appropriations for the 7(a) Loan Guaranty program, or the government overcharges borrowers and lenders and there is excess funding to run the program, the Administration will lower fees on borrowers and lenders. The current statute only allows fees to be lowered on borrowers. The section also limits the amount of appropriations that can be applied to reducing fees—the average of the three most recent years for which there were re-estimates.

Sec. 309. International trade loans

This section increases the maximum loan guarantee amount to $2.75 million and specifies that the loan cap for International Trade Loans is $3.67 million, as well as sets out that working capital is an eligible use for loan proceeds. The bill also makes international trade loans consistent with regular SBA 7(a) loans in terms of allowing the same collateral and refinancing terms as with regular 7(a) loans.

Sec. 310. Rural Lending Outreach Program

This section creates a new 7(a) loan to increase lending in rural areas. The maximum loan is $250,000 and provides incentives to lenders to participate, with an 85 percent guarantee and a requirement of the SBA to process loans within 36 hours. It streamlines 7(a) lending by requiring a short application and minimum documentation, and makes the eligibility requirements on the borrower more flexible.

Title IV—Certified Development Companies; 504 Loan Program

Sec. 401. Development company loan programs

This section renames the 504 Loan program as the Local Development Business Loan Program (LDB program)

Sec. 402. Loan liquidations

This section provides that a certified development company (CDC) can elect not to foreclose or liquidate its own defaulted loans, and can instead contract with a third party to carry out the foreclosures and liquidations. CDCs can receive reimbursement from the SBA for foreclosure expenses that the SBA authorizes.

Sec. 403. Additional equity injections

This section makes it possible for any equity provided by the borrower, beyond the minimum injection (down-payment) required, to be used to reduce the contribution amounts from the non-CDC portion of the loan deal. The purpose of the section is to help the borrower save money by buying down the other portions of the loan which often have less favorable terms or interest rates than the CDC portion of the loan.

Sec. 404. Uniform leasing policy

This section makes uniform the leasing policy between 7(a) and 504 loans, by setting a common standard that allows 50 percent of a facility to be leased on a new or existing building. This eliminates the current distinction between new and existing construction.

Sec. 405. Businesses in low-income communities

This section provides incentives for businesses to locate in low-income communities. It allows for businesses in low-income communities that would qualify for a New Markets Tax Credit to qualify as "public policy goal" loans in the 504 loan program. It Increases the loan limit from $2 million to $4 million. It also adds two incentives, including a provision to increase the size standard limitation on a business by 25 percent, and another provision to decrease the additional personal liquidity down payment of a business owner by 25 percent.

Sec. 406. Combinations of certain goals

This section allows businesses to qualify as "minority owned" for purposes of qualifying as a public policy goal loan if a majority of the business's ownership interests belong to one or more individuals who are minorities.

Sec. 407. Refinancing under the local development business loan program

This section permits a borrower to refinance a limited amount, based on a formula, of the business's pre-existing debt, if that debt is already secured by a mortgage on the property being expanded by the new loan.

Sec. 408. Technical correction

This section corrects a technical drafting error made in legislation enacted in 2004, specifically to Section 501(e)(2) of the Small Business Investment Act of 1958.

Sec. 409. Definitions for the Small Business Investment Act of 1958

This section defines a development company and a certified development company.

Sec. 410. Repeal of sunset on reserve requirements for premier certified lenders

This section would make permanent a temporary statute that allows CDCs qualified by the SBA as "Premier Certified Lenders" to amortize their reserve requirements and withdraw from the reserves the amount attributable to debentures as the debentures are repaid. The statute was set to expire in the summer of 2006 but has been temporarily extended until a three-year reauthorization bill can be enacted.

Sec. 411. Certified development companies

This section provides criteria to identify the types of entities that can qualify as certified development companies (CDCs) and thus participate in the 504 Loan program. The provision also imposes ethical requirements on CDCs, their employees, and banks participating in the program. This section provides minimum requirements for CDCs regarding members, boards of directors, staffing and management expertise, and use of proceeds. The section details requirements CDC loan review committees must meet in order to ensure that CDCs pursue local development goals, and allows CDCs operating in multiple states to elect to maintain their accounting on an aggregate basis. This section also allows CDC board members to assist other CDCs by serving on one other CDC Board.

Sec. 412. Conforming amendments

Sec. 413. Closing costs

This section provides borrowers with the option to include loan and debenture closing costs in their loans.

Sec. 414. Definition of rural

This section conforms the SBA's definition of a 'rural area' in the 504 program, for the purposes of eligibility for a larger loan supporting a 'public policy' goal, to the definition used by the Department of Agriculture.

Sec. 415. Regulations and effective date

This section authorizes and directs the SBA to publish proposed regulations to implement this Act within 120 days of the date of enactment and to publish final regulations within an additional 120 days.

Sec. 416. Limitation on time for final approval of companies

This section establishes a limitation of two years for final approval of companies.

Sec. 417. Child Care Lending Pilot Program

This section creates a three-year pilot, allowing 504 loans to be made to non-profit child care businesses. Currently, only for-profit child care businesses are eligible for 504 loans. The bill requires the same underwriting standards for for-profits as non-profits, with added protections to address the difference between a for-profit with owners and a non-profit without owners. It prohibits more than 7 percent of the total number of 504 loans in any fiscal year to be made for these purposes. The pilot is limited to the 19 states of Committee members.

Sec. 418. Debenture repayment

This section would require that any debenture (or long term bond) issued to provide capital for a development company loan guaranteed by SBA shall provide for the payment of principal and interest on a semiannual basis.

Sec. 419. Real estate appraisals

This section would increase the value of commercial real property given as collateral for a 7(a) or 504 loan on which an appraisal is required. On property valued at more than $400,000, an appraisal would be required (now required on property valued at more than $250,000); and on property valued at less than $400,000 (now $250,000) an appraisal may be required if SBA determines that an appraisal is necessary for the determination of creditworthiness of the borrower. Elimination of unneeded appraisals would reduce loan costs to borrowers by possibly $3,000 to $5,000.

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